

REPORT OF EXAMINATION
OF THE
MENNONITE AID PLAN OF THE PACIFIC COAST
AS OF
DECEMBER 31, 2005

Filed January 5, 2007

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San Francisco, California
October 11, 2006

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

MENNONITE AID PLAN OF THE PACIFIC COAST

(hereinafter also referred to as the Company) at its home office located at 1110 J Street, Reedley, California 93654.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2005. The present examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, an evaluation of assets, and a determination of liabilities as of December 31, 2005, as deemed necessary under the circumstances.

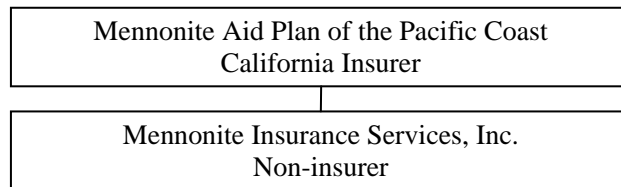
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; officers, employees and agents welfare and pensions plans; growth of company; business in force by states; loss experience; accounts and records; and sales and advertising.

COMPANY HISTORY

The Company was formed as a fraternal organization in 1922 to provide fire insurance for members of the Mennonite and Brethren in Christ churches. It was incorporated under the laws of the State of California on September 14, 1979, and received a Certificate of Exemption pursuant to California Insurance Code Section 9080.1 on September 19, 1979. Because of its statutory exemption, the Company is not subject to most of the insurance laws pertaining to other California insurers. The Company is the only fraternal fire organization still operating in California.

MANAGEMENT AND CONTROL

The Company has a wholly-owned subsidiary, Mennonite Insurance Services, Inc. (MIS). Directors, officers and employees of the Company hold the same positions with MIS. The following organizational chart depicts this relationship:



The Company is managed by a thirteen-member board of directors who are elected annually. The following is a list of the directors and principal officers of the Company as of December 31, 2005:

Directors

Name and Residence

Principal Business Affiliation

Dennis Langhofer
Fresno, California

Teacher

Jim Enns
Clovis, California

Church Conference Treasurer

Name and ResidencePrincipal Business Affiliation

Eugene Gascho
Aurora, Oregon

Landscape Contractor

Alan Grantham
Bellingham, Washington

Businessman

John Hochstetler
Salem, Oregon

Agriculture Supplies

Ira Kauffman
Lebanon, Oregon

Retired

Nancy McEnroe
Bakersfield, California

Housewife

Ron Peters
Reedley, California

Agriculture

Don Shafer
Pinion Springs, California

Retired

Vern Warkentin
Reedley, California

Business Owner

Alan Whaley
Phoenix, Arizona

Pastor

Ron Wiens
San Jose, California

Business Owner

Principal OfficersNameTitle

Dennis Langhofer
Jim Enns
Ron Peters

President
Secretary
Treasurer

Management Agreements

The Company and Mennonite Insurance Services, Inc. (MIS) entered into an inter-company operating agreement on May 1, 1996. Under the terms of this agreement, the Company rents its office building and equipment to MIS for a fee of \$1,650 per month. MIS provides its employees to the Company for a fee based on the proportional employment costs incurred.

TERRITORY AND PLAN OF OPERATION

The Company operates under a Certificate of Exemption pursuant to California Insurance Code (CIC) Section 9080.1 which authorizes it to write fire insurance and provide extended coverage for other types of losses as allowed under CIC Section 9095.

As of December 31, 2005, the Company was licensed to write insurance in California and Oregon, and wrote on a surplus lines basis in Arizona and Washington. During 2005, gross premiums written were \$1.43 million. California and Oregon accounted for 84.2% and 8%, respectively, of gross premiums written during the year.

Business is produced by its wholly-owned subsidiary, Mennonite Insurance Services, Inc. (MIS). There are five licensed insurance agents at MIS. New business is acquired through referrals, contacting potential clients from church directories and outside advertising.

REINSURANCE

Assumed

The Company's Certificate of Exemption does not allow it to assume reinsurance.

Ceded

The following are the treaties in force as of December 31, 2005:

Type of Contract	Reinsurer's Name and Participation	Company's Retention	Reinsurer's Maximum Limits
Obligatory First Surplus Treaty	American Agricultural Insurance Company - 5.2% - Unauthorized Arch Reinsurance Company – 10% - Authorized Catlin Insurance Company Ltd. - 21.6% - Unauthorized Employers Mutual Casualty Company - 3.2% - Authorized Harco National Insurance Company – 60% - Authorized	Twelve lines, minimum retention of \$45,000 per risk	Maximum cession of \$540,000 per risk. If the reinsured policy provides additional coverage beyond the stated policy limit, the limit of liability of the reinsurer shall be increased by an amount equal to the reinsurer's proportionate share of such additional coverage, but not to exceed 20% of its limit of liability stated above
Aggregate Excess of Loss	Brit Insurance Limited - 21.2% - Unauthorized Lloyd's Syndicate #2987 - 21.2% - Unauthorized Lloyd's Syndicate #2147 – 10% - Unauthorized Lloyd's Syndicate #0609 - 3.3% - Unauthorized Lloyd's Syndicate #4444 - 11% - Unauthorized Aspen Insurance UK Limited - 33.3% - Authorized	The greater of \$230,400 plus 5% of ultimate net loss in excess of \$230,400 or 10% of gross net earned premium income	95% of ultimate net losses excess of the greater of \$230,400 or 90% of gross net earned premium income, subject to a limit of liability of the lesser of \$912,000 or 95% of 250% of gross net earned premium income

The Company is not in compliance with California Insurance Code (CIC) Section 922.2(a) because the insolvency clause in its ceded reinsurance agreements does not meet the “in substance” requirement due to references to New York insurance laws. References to any laws other than that of the State of California are not allowed in a reinsurance agreement where the ceding company is a California domestic insurer. It is recommended that the Company comply with CIC Section 922.2(a) by amending its reinsurance agreements to remove the references to New York laws. In response to this finding, the Company stated that it will amend the 2007 reinsurance agreements to comply with CIC Section 922.2(a).

During the exam period the Company ceded reinsurance to unauthorized reinsurers that do not meet the requirements for granting credit for reinsurance as outlined in CIC Section 922.4. In

order to claim credit for reinsurance under CIC Section 922.5(b), the Company obtained letters of credit from the unauthorized reinsurers. However, the letters of credit held by the Company as of December 31, 2005 were insufficient to permit full credit for reinsurance. The letters of credit were deficient by \$87,149. No examination adjustment was made because the amount is immaterial. It is recommended that the Company implement procedures to ensure that the letters of credit are sufficient to cover all reinsurance credit claimed on account of unauthorized reinsurers in accordance with CIC Section 922.5(b).

FINANCIAL STATEMENTS

The following financial statements are included in this report of examination:

Statement of Financial Condition as of December 31, 2005

Underwriting and Investment Exhibit for the Year Ended December 31, 2005

Reconciliation of Surplus as Regards Policyholders, December 31, 2002
through December 31, 2005

Statement of Financial Condition
as of December 31, 2005

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Non- Admitted Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 1,334,823	\$	\$ 1,334,823	
Stocks:				
Preferred stocks	150,000		150,000	
Common stocks	5,205,093	408,754	4,796,339	
Real estate	176,189		176,189	
Cash and short-term investments	1,229,512		1,229,512	(1)
Aggregate write-ins for investments	554,401		554,401	
Investment income due and accrued	32,004		32,004	
Reinsurance:				
Amounts recoverable from reinsurers	54,226		54,226	
Current federal income tax recoverable	17,968		17,968	
Electronic data processing equipment	5,461		5,461	
Furniture and equipment	<u>4,708</u>	<u>4,708</u>	<u></u>	
Total assets	<u>\$ 8,764,385</u>	<u>\$ 413,462</u>	<u>\$ 8,350,923</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses and loss adjustment expenses			\$ 68,375	(2)
Net deferred tax liability			342,612	
Unearned premiums			139,530	(3)
Ceded reinsurance premiums payable			145,405	
Amounts withheld or retained by company for account of others			<u>5,057</u>	
Total liabilities			700,979	
Unassigned funds		<u>\$ 7,469,944</u>		
Surplus as regards policyholders			<u>7,469,944</u>	
Total liabilities, surplus and other funds			<u>\$ 8,350,923</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2005

Statement of Income

Underwriting Income

Premiums earned		\$ 293,667
Deductions:		
Losses incurred	\$ 131,708	
Loss expenses incurred	73,705	
Other underwriting expenses incurred	<u>427,717</u>	
Total underwriting deductions		<u>633,130</u>
Net underwriting loss		(339,463)

Investment Income

Net investment income earned	\$ 187,884	
Net realized capital gains	<u>324,268</u>	
Net investment gain		<u>512,152</u>
Net income before federal income taxes		172,689
Federal income taxes incurred		<u>8,627</u>
Net income		<u>\$ 164,062</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2004		\$ 7,424,154
Net income	\$ 164,062	
Change in net unrealized capital gains	94,641	
Change in net deferred income tax	(32,179)	
Change in nonadmitted assets	<u>(734)</u>	
Change in surplus as regards policyholders for the year		<u>225,790</u>
Surplus as regards policyholders, December 31, 2005		<u>\$ 7,649,944</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2002 through December 31, 2005

Surplus as regards policyholders, December 31, 2002, per Examination			\$ 6,734,671
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 39,937	\$	
Change in net unrealized capital gains	1,316,700		
Change in net deferred income tax		447,678	
Change in nonadmitted assets	<u> </u>	<u>2,452</u>	
Totals	<u>\$ 1,356,403</u>	<u>\$ 450,130</u>	
Net increase in surplus as regards policyholders			<u>915,273</u>
Surplus as regards policyholders, December 31, 2005, per Examination			<u><u>\$ 7,649,944</u></u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Cash and Short-term Investments

At the examination date there were several unclaimed checks that have been outstanding for more than three years. It is recommended that these unclaimed checks be escheated to the State of California as required under the California Unclaimed Property Law. This is a repeat finding from the prior examination.

(2) Losses and Loss Adjustment Expenses

A review of 2005 losses paid through the end of June 30, 2006 indicated that the Company's reported reserves at December 31, 2005 were deficient by \$8,279. Additionally, there were five claims with loss dates in 2005 representing net losses of \$487 that the Company did not establish a reserve for as of December 31, 2005. No examination adjustment was made since the amount is immaterial. It was recommended that the Company establish loss reserves for all reported claims. In response to this finding the Company stated that it will take steps to assign reasonable reserves for the report claims.

(3) Unearned Premiums

The Company uses premium deposit dates instead of policy effective dates when calculating its unearned premium reserve. As a result, all premium deposits are treated as current year written premium resulting in some advance premiums being improperly included in premiums written and unearned premiums at December 31, 2005. It is recommended that the Company exclude advance premiums from the current year written premiums and unearned premium reserve and set up a separate liability for advance premiums.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Reinsurance – Ceded (Page 4): It is recommended that the reinsurance agreements be amended to remove the references to New York laws.

It is recommended that the Company implement procedures to ensure that the letters of credit are sufficient to cover all reinsurance credit claimed on account of unauthorized reinsurers in accordance with CIC Section 922.5(b).

Comments on Financial Statement Items – Cash (Page 10): It is recommended that the Company escheat immediately those unclaimed checks that have been outstanding for more than three years to the State of California as required under the California Unclaimed Property Law. This is a repeat finding from the prior examination.

Comments on Financial Statement Items – Losses and Loss Adjustment Expenses (Page 10): It is recommended that the Company establish loss reserves for all reported claims.

Comments on Financial Statement Items – Unearned Premiums (Page 10): It is recommended that the Company exclude advance premiums from the current year written premiums and unearned premium reserve and set up a separate liability for advance premiums.

Previous Report of Examination

Management Agreements (Page 4): No formal written agreement existed for the claims adjusting and inspection services arrangement between the Company and D&M Adjusting and Insurance Services (D&M). The Company stated that it terminated its business relationship with D&M.

Comments on Financial Statement Items – Cash (Page 11): It was recommended that the

Company comply with the California Unclaimed Property Law. In response to the prior examination finding, the Company adopted written escheat procedures to comply with the Unclaimed Property Law. However, the Company has not made any filings as of the examination date to demonstrate its compliance.

Comments on Financial Statement Items – Unearned Premiums (Page 11): It was recommended that the Company comply with California Insurance Code Sections 922.4 and 922.5. The Company has not complied with this finding.

ACKNOWLEDGEMENT

The assistance and cooperation of the officers and employees of the Company and its Certified Public Accountant during the course of this examination is acknowledged.

Respectfully submitted,

/s/
Ber Vang, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California